

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 BOB STUMP
CHAIRMAN
3 GARY PIERCE
COMMISSIONER
4 BRENDA BURNS
COMMISSIONER
5 ROBERT BURNS
COMMISSIONER
6 SUSAN BITTER SMITH
COMMISSIONER
7

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9 IN THE MATTER OF THE APPLICATION OF
10 FAR WEST WATER & SEWER, INC., AN
11 ARIZONA CORPORATION, FOR A
12 DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
WASTEWATER RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE.

Docket No. WS-03478A-12-0307

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14 **RUCO'S REPLY BRIEF**

15 The Residential Utility Consumer Office ("RUCO") hereby submits its Reply Brief in
16 the above-referenced matter. Far West Water & Sewer, Inc. ("Far West" or "the
17 Company") and RUCO have resolved the issues relating to working capital, repairs and
18 maintenance expense, merit pay, bad debt expense, salaries and wages, imputed
19 revenue, capital structure and single-family residential rate design. The parties remain at
20 odds on the issues of: 1) exclusion of the excess capacity of the Company's plant and
21 associated adjustments, 2) the appropriate return on equity ("ROE" or "COE"), and 3) rate
22 design. RUCO has addressed these issues in its initial Closing Brief and incorporates by
23 reference its comments therein. RUCO supplements its prior comments to address
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specific issues of exclusion of plant which is not used and useful and cost of equity capital, raised by the Company in its Closing Brief.

A. RUCO's disallowance of plant which is not used and useful is well-reasoned and supported by the weight of the evidence.

1. RUCO calculated system-wide design capacity is supported by the Company's testimony and admissions.

The Company asserts that RUCO's disallowance of plant is "seriously flawed" in part because it used a design capacity that is not correct. The Company's argument borders on the absurd because RUCO's determination of total design capacity of 2,332,500 GPD was in large part based on the Company's admission of its design capacity. In direct testimony, the Company avowed the design capacity of its plant to be:

WWTP	TREATMENT TYPE	DESIGN CAPACITY
Marwood 14000 E. 56th St.	SBR	340,000 GPD
Section 14 12651 Avenue 14E	MBR	1,300,000 GPD
MDS - Villa Royale 12342 E. Del Rico	Ext. Aeration	10,000 GPD
MDS - Del Oro 1171 7 Omega Lane	MBR	495,000 GPD
MDS - Del Rey 12342 E. Del Rico	Ext. Aeration	37,500 GPD
Seasons 10301 County 10th St.	SBR	150,000 GPD ¹

¹ See Exhibit R-26 and Exhibit A-1, Direct Testimony of Ray Jones, Schedule RLJ-DT2

RUCO should be able to rely on the Company's testimony, but RUCO also verified the information by reviewing the Company's statement of capacity in its annual report for the test year. In 2012, the Company filed an annual report for the 2011 test year.² The annual report included the following verbatim description of plant capacity:³

Far West Water & Sewer, Inc.
Wastewater Division
Inventory Number 44-004
Wastewater Plant Design Capacities
2011
Attachment E

<u>WWTP</u>	<u>TREATMENT TYPE</u>	<u>DESIGN CAPACITY</u>
Marwood 14000 E. 56th St.	SBR	340,000 GPD
Section 14 12651 Avenue 14E	MBR	1,300,000 GPD
MDS - Villa Royale 12342 E. Del Rico	Ext. Aeration	10,000 GPD
MDS - Del Oro 11717 Omega Lane	MBR	495,000 GPD
MDS - Del Rey 12342 E. Del Rico	Ext. Aeration	37,500 GPD
Seasons 10301 County 10th St.	SBR	150,000 GPD

The above reported information reflecting design capacity of 2,332,500 GPD was provided under oath by the Company's representatives who avowed to the veracity of the statements contained in the annual report as follows⁴:

HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

² See Exhibit R-3 and R-26, excerpt from Annual Report and Exhibit A-1, Direct Testimony of Ray Jones, Schedule RLJ-DT2

³ *Id.*

⁴ *Id.*

RUCO also inspected the Company's facilities and reviewed its Aquifer Protection Permits.⁵ In its annual report for 2012, the Company acknowledges its facilities have the following permitted design capacity:

WWTP	APP Permit	DESIGN CAPACITY
Marwood 14000 E. 56th St.	102829	340,000 GPD
Section 14 12651 Avenue 14E	105014	1,300,000 GPD
MDS - Villa Royale 12342 E. Del Rico	100221	10,000 GPD
MDS - Del Oro 1171 7 Omega Lane	101816	495,000 GPD
MDS - Del Rey 12342 E. Del Rico	101814	37,500 GPD
Seasons 10301 County 10th St.	103618	150,000 GPD ⁶

Contrary to the Company's assertions, RUCO did not arbitrarily derive design capacity for the Company's WWTP. It relied on the Company's admissions set forth in its testimony and in its sworn statements in its test-year annual report, its review of the Company's APPs and its personal inspection.⁷ The Company's test year annual report, direct testimony and APPs reflect a design capacity consistent with RUCO's determination of design capacity. RUCO's inspection of the facilities confirmed that with the exception of two missing membranes and a potentially unnecessary vadose well, all of the systems

⁵ See Exhibit R-9 and R-10, Direct and Surrebuttal Testimony of Royce Duffett.

⁶ See Exhibit R-3 Excerpt from Company's annual report, Exhibit R-25 APP-105014(Section 14); Exhibit R-31 APP 101816(Del Oro); Exhibit R-32 APP 106318 (Seasons). See also Exhibit A-1, Direct Testimony of Ray Jones, Schedule RLJ-DT2

⁷ *Id.*

1 operate at their permitted design capacity. RUCO did not err in deriving design capacity of
2 2,332,500 GPD.

3 **2. In calculating demand capacity, RUCO used a well-reasoned, well-**
4 **supported estimate of future growth.**

5 The Company alleges that RUCO's disallowance is "seriously flawed" because
6 RUCO calculated demand capacity based on an "arbitrary 10%" calculation of future
7 growth and not based on a five-year growth projection. The Company has
8 mischaracterized RUCO's testimony. RUCO's calculation of future growth was based on a
9 five-year planning horizon and it was not arbitrary.⁸ RUCO's future growth estimate was
10 based on census bureau data for the zip code of 85367 and Yuma County. The
11 Company's CC&N is located in zip code 85367 in Yuma County.⁹ While the Company
12 may disagree with the census data's projections, it can hardly refute that the census
13 bureau is a good data source for population growth estimates. According to the census
14 bureau the population of these areas experienced a growth of 16.45 percent and 22.32
15 percent, respectively, from 2000 to 2010.¹⁰ The average of the two growth rates from the
16 census bureau is 19.38 percent divided by two resulting in a 5-year growth rate of 9.69
17 percent or approximately 10.00 percent as calculated by Mr. Duffett.

18 Mr. Duffett's five-year growth rate of 10 percent is also fair in light of the Company's
19 actual reported growth. According to the Company's rate case filing in 2008, Far West
20 Sewer had 7,199 residential customers.¹¹ According to the Company's current application
21 Far West Sewer has 7,067 residential customers or a negative 1.75 percent.¹² During the

22 ⁸ T: 473, ll. 24-25.

23 ⁹ See Exhibit R-9, pp.2-3.

24 ¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

1 same time period the commercial customers increased from 38 to 44.¹³ Mr. Duffett's
2 growth estimate of 10 percent is well-founded, well-reasoned and more than fair when
3 compared to the Company's actual negative growth.

4 The Company asserts that RUCO should have used growth estimates made by Mr.
5 Jian Liu, Staff's engineer. Mr. Liu acknowledged in testimony that he did not
6 independently derive a growth estimate; he simply adopted the Company's growth
7 estimate.¹⁴ Mr. Liu testified:

8 **Q. The next issue I would like to talk to you about, Mr. Liu, is your discussion of**
9 **growth in your report. On page 2 of your surrebuttal report, you calculated growth**
10 **at 9,000 customers by the end of 2016, correct?**

11 **A. That's right.**

12 **Q. And you base that off the company's estimates of 1100 to 1200 new customers by**
13 **2016, correct?**

14 **A. Yes.**

15 **Q. Did you do any independent verification or analysis of the issue of growth in the**
16 **service area before you reached your conclusions?**

17 **A. No.**

18 **Q. So what you did is adopt the company's analysis here?**

19 **A. Yes.**¹⁵

20 Staff witness, Mr. Liu admitted unequivocally that he did not independently analyze the
21 issue of growth. He simply adopted the Company's projections. The Company's assertion
22 that RUCO should have adopted the Staff's calculations, when Staff made no independent
23 analysis is without merit.

24 ¹³ *Id.*

¹⁴ T: 716-717.

¹⁵ *Id.*

1 **3. RUCO's application of a 30.1 percent disallowance of plant is fair**
2 **and reasonable.**

3 The Company asserts that RUCO's application of a 30.1 percent to UPIS is unfair
4 because it should have been applied to unadjusted test year plant. First, if there is any
5 confusion, it is of the Company's making. The Company, not RUCO represented its
6 adjusted test year plant as \$37 million with a design capacity of 2.3 MGD in direct
7 testimony.¹⁶ Second, if RUCO had made it's adjustment to a \$39 million unadjusted test
8 year plant, it would only serve to increase RUCO adjustment from \$10,936,720 to
9 \$11,588,446.¹⁷ While subsequent modification in testimony regarding capital structure,
10 cost of equity and other adjustments may nominally impact RUCO's ultimate required
11 revenue requirement, none of these modifications impact the rationale for RUCO's 30.1
12 percent adjustment to UPIS, as filed. RUCO's 30.1 percent adjustment is derived purely
13 from a comparison of design and demand capacity. RUCO's determination of design
14 capacity was based on the Company's avowals. RUCO determination of demand capacity
15 was based on reasonable estimates of current and projected demand. RUCO fully
16 discussed the basis for its 30.1 percent adjustment in its initial Closing Brief and
17 incorporates those arguments by reference.

18 **4. The Company's 17 percent adjustment for excess capacity is unfair**
19 **to current ratepayers.**

20 The Company's \$2,165,201 adjustment to Section 14 is unfair and unreasonable to
21 current ratepayers. Section 14 unadjusted test year plant in service is \$12,583,565. The
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23 ¹⁶ T: 432

24 ¹⁷ See Exhibit R-8.

unadjusted test year plant is irrefutably 1.3 MGD.¹⁸ The Company's witness, Mr. Jones calculated current use of Section 14 as follows:

	Avg Day Connected <u>Lots</u>	Max Day (GPDUPD)	Max Month (GPDUPD)
Section 14	1,254		
Palm Shadows	1,787		
RV	<u>712</u>		
Total Units	3,753	136.16	104.18 ¹⁹

Further, Mr. Jones calculated future growth and estimated that only .692 GPD of the Section 14's unadjusted plant will be used and useful in five years, if the Company completes the transfer of 753 Marwood customers to Section 14 via the Lift Station 16.²⁰

His calculations of used and useful test year plant at Section 14 are as follows:

	Avg. Day <u>Lots</u>	Max Day (MGD)	Max Month (MGD)
Test Year	3, 753	0.511	0.391
Projected 5-Yr Growth	500	0.068	0.052
L.S. 16 Transfer (Residential)	753	0.103	0.078
L.S. 16 Transfer (Commercial)		<u>0.010</u>	<u>0.008</u>
		0.692	0.529 ²¹

Applying the Company's adjustment to unadjusted test year plant, (including all Phase II plant,) would result in a finding that 53.22 will be used and useful within a five-year planning horizon. Stated differently, by the Company's own calculations, 46.78 percent of Section 14's unadjusted test year plant will not be used and useful within a five-year

¹⁸ RUCO believes that the adjusted test year plant is designed, built and permitted at 1.3 MGD. RUCO does not believe it is fair for the Company to remove one or two plant components necessary to operate the plant at 1.3 MGD and somehow render the plant .681 MGD when all other component are designed, built and permitted at 1.3 MGD.

¹⁹ See R-14 Excerpt from Company's schedules.

²⁰ *Id.* Transfer of Marwood customer's would result in a commensurate reduction in demand capacity at Marwood WWTP or 30 percent reduction (753 x 136 GPD=102,408GPD/340,000GPD or 30 percent).

1 planning horizon.²² An adjustment of 46.8 percent to the unadjusted test year plant would
2 be a \$5,889,108.²³ The Company acknowledges that the Section 14 plant, save three
3 membranes and possibly, a vadose well, are built to 1.3 MGD, but applies a \$2,165,201 or
4 17 percent adjustment to the Section 14 unadjusted test year plant in service to reflect
5 plant not used and useful. The impact of the Company's adjustment is to require current
6 ratepayers to subsidize the cost of an additional \$3,723,907 of plant for future
7 ratepayers.²⁴ Such cross-generational subsidization does not reflect cost of service and is
8 unfair and unreasonable. It is particularly unfair to impose such cross-subsidization when
9 the Company is asking the current ratepayers to absorb a rate increase in excess of 100
10 percent to serve their current needs. To mitigate the impact of the rate increase, the
11 Commission should not require current ratepayers to subsidize the cost of plant which is
12 more properly allocated for the use of future ratepayers.

13 **5. RUCO's system-wide adjustment is fair and reasonable.**

14 The Company asserts that RUCO should have made its adjustment to specific plant
15 as opposed to making system-wide adjustments because the Company argues that each
16 system serves a separate and distinct service area. That is not entirely true. It is the
17 Company's intention to merge Villa Royale and Villa del Sol with Del Oro and the
18 Company has built the Del Oro designed and permitted the plant to accommodate flows
19 from the smaller plants.²⁵ Moreover, it is the Company's intention to merge Palm Shadows
20 and portions of Marwood with Season 14. To that end, the Company has completed the
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22 ²¹ See Exhibit R-14.

23 ²² *Id.*

23 ²³ 46.8 percent x \$12,583,565 = \$5,889,108

23 ²⁴ \$5,889,108 - \$2,165,201 = \$3,723,907.

24 ²⁵ See Exhibit R-25 APP-105014(Section 14); Exhibit R-31 APP 101816(Del Oro); Exhibit R-32 APP 106318 (Seasons).

1 Palm Shadows Force Main and collection systems and lift stations to collect flows from
2 Marwood.²⁶ Likewise, the Company has expanded the capacity of Section 14 to
3 accommodate those flows.²⁷ It is the Company's intention to modify Seasons WWTP
4 using a Zenon MBR system previously used on a temporary basis at Del Oro and
5 subsequently transferred to the Season plant.²⁸ According to the Company much of that
6 construction has been completed.²⁹ There is a significant merging of the service areas
7 and intermingling of plant in service. Although the Company may not have completed the
8 merger of its systems, the Company has included in UPIS significant expansions and of
9 Del Oro and Section 14 to accommodate additional flows and modified Seasons plant to
10 encompass the Zenon MBR plant previously installed at Del Oro. The fact that the
11 Company seeks to include plant in rate base to accommodate the merger of systems while
12 also continuing to rate base plant intended to be merged in expanded systems should not
13 be lost upon this Commission. Moreover, if the Company cannot be bothered to submit its
14 application for a rate increases based on a system-specific cost of service, bill counts, etc.
15 it is disingenuous for the Company to oppose adjustments to plant in service on a system-
16 wide basis.

17 **6. Company's late filed analysis of cost of equity should be stricken**

18 In its pre-filed testimony, the Company requested 10 percent return on equity capital
19 with little analysis "in consideration of the magnitude of rate increase request...to mitigate
20 the impact of the rate request and eliminate the contested issues."³⁰ The Company
21 provided no independent analysis of the issue in direct testimony beyond a comparison of
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23 ²⁶ See R-14 Excerpt from Schedule B-2. See also Exhibit A-1, Direct Testimony of Ray Jones.

24 ²⁷ *Id.*

²⁸ T:963-964.

²⁹ *Id.*

1 the debt ratios and returns on equity authorized by the Commission in six cases.³¹ In
2 rebuttal testimony, the Company noted the Commission had adopted returns on equity in
3 two additional cases which exceeded its requested return, but provided no further analyses
4 other than to adopt Staff's position.³² Staff's analysis included a DCF and CAPM analyses
5 similar to RUCO's to arrive at a cost of equity capital of 8.5 percent before upward
6 adjustments of 60 basis points for economic instability and 90 basis points for financial
7 risk. In its Closing Brief, pages 13-16, the Company, for the first time analyzes the issue
8 using facts and argument not made during the course of the hearing. Inclusion of such
9 information after the close of evidence is inconsistent with the principles of notice and due
10 process. RUCO requests that the ALJ strike those portions of the Company's Closing
11 Brief which do not relate to the evidence submitted by the Company in its case-in-chief.

12 RESPECTFULLY SUBMITTED this 2nd day of July, 2013.

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15 _____
Michelle L. Wood
16 Counsel
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23 ³⁰ Exhibit A-1, Direct Testimony of Ray Jones, pp. 16-17.

24 ³¹ *Id.*

³² Exhibit A- 2, Rebuttal Testimony of Ray Jones, pp. 24.

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